

# IDAHO OUTLOOK

## NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT

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**R**ecession, interrupted? Economists were surprised real GDP grew at a 0.2% annual rate in the final quarter of last year. The consensus was that it would decline in that quarter. This was a surprising reversal from the 1.3% contraction in 2001's third quarter. The one-quarter decline has raised some questions about the recession. For example, the rule-of-thumb definition for a recession (two or more consecutive quarters of declining real GDP) has not been met, so has a recession even occurred? Or has the recession been mild and the economy is rebounding ahead of schedule? There are other hints a recovery is underway. The U.S. Department of Labor recently announced that business productivity jumped in the fourth quarter of last year. Productivity determines how fast the economy can grow in the long run and how quickly living standards improve.

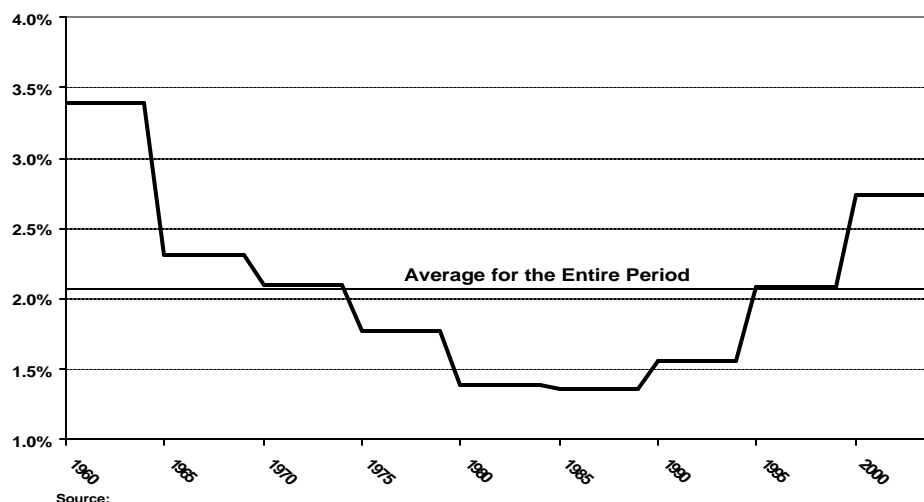
**G**iven the positive economic data, should we be holding a belated recovery party for the economy? Before putting on our party hats and singing rousing choruses of "Happy Days are Here Again," there are several factors that suggest such a celebration may be premature. And it may be a good idea to put down that handful of confetti while considering the following information. The real GDP number for the last quarter of 2001 is an advance estimate. As such, it is subject to revision. And history suggests the difference between the advance and final estimate may be huge. According to the U.S. Department of Commerce, the final estimate for real GDP annual change in last year's fourth quarter could range from a 0.4% decrease to a 1.1% increase. Thus, it is still possible that the final data will show real GDP declined in the fourth quarter of 2001.

**E**ven if the final data shows the economy did grow in the fourth quarter of last year, this still does not mean the recession ended in the third quarter of 2001. This is because, more often than not, a recession contains short growth spurts. Standard and Poor's Chief Economist, David Wyss, reminds us that

nearly every recession since the 1950s had a positive quarter sandwiched between negative quarters. The one exception was the 1990-91 recession. If the economy does perform as it has in the past, and real GDP shrinks in the first quarter of 2002 after expanding in the last quarter of 2001, then the recession could actually last longer than had been anticipated. But this is not likely to happen. Most economists still believe the final GDP data will

**A**rise in productivity is usually good news. This is because it increases the trend growth rate of the economy and improves the standard of living. During the second half of the 1990s, business productivity grew by as much as 3.4% per year, reversing the slow growth that plagued the U.S. during most of the 1970s and 1980s. As a result of the strong productivity gains, real GDP rose by 3.6% in

**Average Nonfarm Semi-Decade Productivity Growth**



show the economy shrank in the last quarter of 2001 and began expanding in the first quarter of this year.

**I**t should be pointed out that real GDP is also being affected by the events of September 11, 2001. This has resulted in large swings in an important component of real output. Namely, the price index for gross domestic purchases, which measures prices paid by U.S. residents, has gone from a 0.1% reduction in the third quarter of 2001 to a 0.4% increase in the fourth quarter of that year. This swing in the price index reflects the way insurance payments for the terrorists' attacks are accounted for in calculating the index. Excluding the insurance-related price effects, the price index decreased 0.3% in the fourth quarter after increasing 0.6% in the preceding quarter.

1996 and by at least 4.0% annually from 1997 to 2000. This was well above the previously assumed trend growth rate of 2.5% to 3.0%.

**S**ometimes the rise in productivity is bad news. In the short run, it is influenced by the stage of the business cycle. Productivity increases as long as output is growing faster than hours of labor. During a recession, productivity will rise even when both output and hours are falling. This is thought to be the cause of the 3.4% jump in productivity in the last quarter of 2001. Business (not total) output fell 0.3% in that quarter while the number of hours worked dropped 3.6%. But there is a silver lining to this, because it typically happens in the waning days of a recession.

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## General Fund Update

As of January 31, 2001

| <u>Revenue Source</u>                 | <u>\$ Millions</u>                         |                             |                              |
|---------------------------------------|--|-----------------------------|------------------------------|
|                                       | FY02<br>Executive<br>Estimate <sup>3</sup> | DFM<br>Predicted<br>to Date | Actual<br>Accrued<br>to Date |
| Individual Income Tax                 | 940.2                                      | 541.9                       | 519.6                        |
| Corporate Income Tax                  | 93.4                                       | 41.7                        | 31.4                         |
| Sales Tax                             | 659.4                                      | 403.5                       | 401.2                        |
| Product Taxes <sup>1</sup>            | 20.6                                       | 12.5                        | 12.5                         |
| Miscellaneous                         | 110.6                                      | 47.2                        | 45.8                         |
| <b>TOTAL GENERAL FUND<sup>2</sup></b> | <b>1,824.2</b>                             | <b>1,046.8</b>              | <b>1,010.5</b>               |

<sup>1</sup> Product Taxes include beer, wine, liquor, tobacco and cigarette taxes  
<sup>2</sup> May not total due to rounding  
<sup>3</sup> Revised Estimate as of January 2002

January brought the second consecutive month of General Fund revenue disappointment, falling \$16.0 million short of the predicted level. Just two months into the new executive forecast, revenue is down \$36.3 million. Last month's problem was concentrated in Corporate Income Tax estimated payments. This month's problem is concentrated in Individual Income Tax withholding collections. Both appear to be heavily impacted by year-end phenomena that do not necessarily shed light on how the five remaining months of Fiscal Year 2002 will perform.

Individual Income Tax revenues were \$17.2 million lower than expected in January. \$14.1 million of this was due to weak withholding collections. On average, January withholding receipts are 28% higher than December. Fourteen percent is the lowest increase in the past 16 years. This year, January withholding grew by just 7.9%. Tax Commission

sources, with some of the large withholding accounts that are behind this weakness, suggest it is primarily due to extremely low profit sharing and bonus payments at year-end. Those sources clearly indicated January's weakness is not expected to continue in the months ahead, at least not in January's magnitude. Refunds were about \$1.1 million higher than expected in January, and filing payments were \$2.1 million lower than expected. While these results contributed to January's overall weakness, neither is particularly noteworthy in magnitude.

Corporate Income Tax collections staged a modest rebound of \$2.2 million in January after being December's principal source of weakness. Filing payments were \$0.1 million higher than expected, refunds were \$0.4 million lower than expected, and estimated payments were \$1.5 million higher than expected in January. Corporate Income Tax revenue

remains \$10.3 million lower than expected on a year-to-date basis, but the gap has narrowed.

Sales Tax revenue was \$2.3 million lower than expected in December. While somewhat disappointing, this underperformance is probably most related to the weak Christmas selling season. As such, it does not have any great predictive power for what is likely to occur in the months ahead. Looking ahead, better than expected economic performance on the one hand is tempered by the aftermath of automobile financing incentives on the other.

Product Taxes again came in exactly on target, and Miscellaneous Revenue was \$1.3 million higher than predicted in January. The strong miscellaneous performance offset just under half of this category's shortfall that opened up in December.